Assessing Workers’ Compensation Schemes in an Incomplete Contracts Framework

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Management of workplace injuries and compensation of injured workers is an important social issue with high financial and social cost implications. Australia is one of only three countries to possess different state-based workers' compensation schemes with varying degrees of government control. Empirical evidence suggests that the frequency rate and duration of injury differ across the different schemes. Public government schemes exhibit double the injury incidence rate but return injured workers back to work twice as fast as private schemes, resulting in lower overall compensation costs. This study develops a theoretical incomplete contracts model to understand the incentives of agents in the different schemes to explain the different experience observed in Australia. We find that an agent in schemes with less government control has a stronger incentive than a government in-house employee to engage in quality of service improvements but also in activities to cut operating costs which reduce the quality of service. The adverse result of cost cutting is less pronounced in a competitive market where the agent is forced to consider the reduction in the quality of service since it results in lower market share. Given the empirical evidence, this suggests that in schemes with less government control, the adverse impact of cost cutting on claims management dominates the benefits from the higher level of quality improving activities. In light of this, greater government control appears favourable in Australian workers’ compensation.

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